No. 303

In the Supreme Court of the United States

OCTOBER TERM, 1942

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

AMERICAN DENTAL COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

INDEX

CITATIONS

496516—42——1

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 303

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

AMERICAN DENTAL COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 38–42) is reported in 44 B. T. A. 425. The opinion of the circuit court of appeals (R. 47–50) is reported in 128 F. 2d 254.

JURISDICTION

The judgment of the circuit court of appeals was entered on May 15, 1942. (R. 51.) The petition for a writ of certiorari was filed on August 14, 1942, and was granted on October 12,

1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether creditors' cancellations, for business reasons, of debts for past due rent and interest owed by the taxpayer, which amounts had been accrued and deducted as business expenses in its tax returns for years prior to 1937, resulted in taxable income to the taxpayer or, as held by the Circuit Court of Appeals, constituted gifts which were exempt from income tax.

2. Whether the cancellations were properly taxable as income for 1937.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the Revenue Act of 1936, c. 690, 49 Stat. 1648, and of Treasury Regulations 94, promulgated under the Act, are set forth in the Appendix, *infra*, pp. 19–21.

STATEMENT

The facts as found by the Board of Tax Appeals may be summarized as follows (R. 38–40):

The respondent taxpayer is a corporation engaged in operating a laboratory where it does prosthetic work for the dental profession. For a number of years it has occupied space in the Mallers Building in Chicago. In December, 1933,

it negotiated a new lease which reduced the annual rent from $15,200 to $8,400. There was then due from the taxpayer $15,298.99 in back rent. Its president notified the rental agent that it was unable to pay all of that amount and requested an adjustment. The agent said that he would make an adjustment. The taxpayer regularly paid the rent under the new lease and in April, 1934, the agent advised the taxpayer that he would accept $7,500 in payment of the back rent and would cancel the remainder. In 1937 taxpayer paid $7,500 in discharge of the back rent and for the first time made an entry on its books showing that back rent in the amount of $7,798.99 had been forgiven. In the same year the landlord likewise for the first time made an entry on its books cancelling the back rent in that amount. (R. 38–39.)

The taxpayer kept its books and made its tax returns upon an accrual basis of accounting. During the years prior to 1934 in which it had failed to pay its rent, it had regularly accrued the rent on its books and taken deductions therefor in its tax returns. Those deductions served to offset income in like amounts for those years. (R. 39.)

In November, 1936, taxpayer was indebted to several creditors for merchandise which they had furnished it over a period of years and for which it had given its interest-bearing notes. It had

been a good customer of these creditors for many years. During the month mentioned it requested three of these creditors to cancel interest on the notes on the ground that they had made similar arrangements with their other customers. The three creditors agreed to cancel all interest accruing after January 1, 1932. The first entry that the taxpayer made on its books showing that the interest had been forgiven was made in December, 1937, when the accounts payable to the three creditors were credited with a total of $16,947.74 representing interest on the notes accruing after January 1, 1932. All of this amount had been deducted by the taxpayer in its tax returns for the years, including 1936, during which the interest had accrued. The deductions had offset income on those returns to the extent of $11,435.22. (R. 39–40.)

Neither in its return for 1937 nor in any other return did taxpayer report any of the cancelled rent or interest as income. The Commissioner in determining deficiencies in income and excess profits tax for 1937 held that the cancelled items constituted taxable income for that year to the extent that they had served to offset income in prior years. Accordingly, he included in taxpayer's income for 1937 the forgiven rent in the amount of $7,798.99 and the cancelled interest in the amount of $11,435.22. (R. 40.)

The Board stated in its opinion that no evidence was introduced to show a donative intent

on the part of any creditor and that the evidence indicated that the creditors "acted for purely business reasons and did not forgive the debts for altruistic reasons or out of pure generosity" (R. 42). Holding that there was no gift, it affirmed the action of the Commissioner in treating the items as taxable income for 1937 and in determinating deficiencies (R. 42).

The Circuit Court of Appeals for the Seventh Circuit reversed the decision of the Board on the ground that the cancellations constituted gifts exempt from income tax since, as the court concluded, they were made without consideration and for the taxpayer's benefit (R. 50).

SPECIFICATION OF ERRORS

The Circuit Court of Appeals erred:

1. In holding that the cancellations of past due indebtedness for interest and rent constituted gifts exempt from income tax.

2. In failing to hold that the cancellations resulted in taxable income.

3. In relying upon Article 64 of Treasury Regulations 77, promulgated under the Revenue Act of 1932, instead of Article 22 (a)–14 of Treasury Regulations 94, promulgated under the Revenue Act of 1936.

SUMMARY OF ARGUMENT

The gains resulting to a solvent debtor from the cancellation of past due rent and interest obliga-

tions which he had accrued and deducted in prior years from income, are taxable income in the year of cancellation. This result is required both by the doctrine of *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, that the cancellation freed assets of the taxpayer for other purposes, and under the theory of *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, that the cancellations effected a restoration to income of previously deducted items.

The cancellations were negotiated as normal business transactions and were made by the creditors in anticipation of commercial benefit with no intention to make a gift. The cancellations therefore resulted in taxable income rather than gifts.

On conflicting evidence the Board correctly determined that the debts were cancelled in 1937. The finding is supported by substantial evidence and is conclusive on appeal.

ARGUMENT

The Commissioner of Internal Revenue correctly determined the deficiency in respondent's 1937 income and excess profits tax return if the cancellations here involved resulted in taxable income to respondent and if that income was taxable for the year 1937. The court below found it unnecessary to decide the latter question because it determined that the cancellations were made as

gifts and therefore did not constitute taxable income. The respondent has indicated that it will contend in this Court that the cancellations, even if not gifts, did not result in taxable income (Brief in Opposition, p. 7). We submit that the cancellations of indebtedness, if not made as gifts, constituted taxable income, that they were not made as gifts, and that they resulted in income to the taxpayer which is properly taxable for 1937.

I

THE CREDITORS' CANCELLATION OF DEBTS FOR PAST DUE RENT AND INTEREST OWED BY THE TAXPAYER, MADE FOR BUSINESS REASONS, RESULTED IN TAXABLE INCOME TO THE TAXPAYER

A. *The forgiveness of indebtedness here, if not made as a gift, results in taxable income to the debtor.*

By the cancellation of the debts here involved a portion of the assets of the debtor were freed for other purposes. That such a release from obligations, if not made as a gift or as a capital contribution, results in the realization of taxable income was established in *United States* v. *Kirby Lumber Co.*, 284 U. S. 1. In a wide variety of circumstances, e. g., by the repurchase of bonds at less than their issuing value by the issuer (*United States* v. *Kirby Lumber Company*, 284 U. S. 1), or his successor in obligation (*Helvering* v. *American Chicle Company*, 291 U. S. 426); or by the compromise of the principal of

(*Haden Co.* v. *Commissioner*, 118 F. (2d) 285 (C. C. A. 5), certiorari denied, 314 U. S. 622; *United States* v. *Little War Creek Coal Co.*, 104 F. (2d) 483 (C. C. A. 4)), or interest on, an obligation (*Helvering* v. *Jane Holding Corp.*, 109 F. (2d) 933 (C. C. A. 8), certiorari denied, 310 U. S. 653, rehearing denied, 311 U. S. 725; *Walker* v. *Commissioner*, 88 F. (2d) 170 (C. C. A. 5), certiorari denied, 302 U. S. 692), the reduction or cancellation of a debt has usually been held to result in taxable income. And the same result is required by the applicable Treasury regulations. (See Treasury Regulations No. 94, Article 22 (a)–14, promulgated under Revenue Act of 1936.)

Occasionally lower federal courts have attempted to qualify the doctrine thus enunciated.[1] Whatever may be said of the merits of some of these attempted modifications,[2] none of them is involved here. Thus it has been held that if the debtor is insolvent he realizes no income by the cancellation of portions of his indebtedness.[3]

---

[1] See footnotes 3, 4, 5, 6, 7, *infra*.

[2] See, Warren and Sugarman, *Cancellation of Indebtedness and Its Tax Consequences*, 40 Col. L. Rev. 1326; Darrell, *Discharge of Indebtedness and the Federal Income Tax*, 53 Harv. L. Rev. 977; Surrey, *The Revenue Act of 1939 and the Income Tax Treatment of Cancellation of Indebtedness*, 49 Yale L. J. 1153.

[3] Cf. *Burnet* v. *John F. Campbell Co.*, 50 F. (2d) 487 (App. D. C.); *Dallas T. & T. Warehouse Co.* v. *Commissioner*, 70 F. (2d) 95 (C. C. A. 5); *Commissioner* v. *Simmons Gin Co.*, 43 F. (2d) 327 (C. C. A. 10).

But this suggestion, even if valid,[4] has no bearing on this case, since the taxpayer is not and was not insolvent. Similarly, it was suggested in *Commissioner* v. *Rail Joint Co.*,[5] 61 F. (2d) 751 (C. C. A. 2), that if the obligation was originally contracted without anything of value being received therefor its cancellation would not result in income to the debtor. But the facts in this case do not present that problem either. Nor, in view of the nature of the transactions and the relationship of its participants, can the cancellations here be regarded as capital contributions,[6] or reductions in the purchase price of property rather than income.[7] In short, even the qualifications which have gained some currency, albeit disputed, in the lower federal courts cannot be urged to remove the transactions in this case from the doctrine of the *Kirby* case. The taxpayer, having

---

[4] See, Warren and Sugarman, *supra*, at 1351–1356; Darrell, *supra*, at 988–990; Surrey, *supra*, at 1157–1167; cf. *Haden Co.* v. *Commissioner*, *supra*.

[5] Cf. *Helvering* v. *American Chicle Co.*, *supra*; *Commissioner* v. *Coastwise Transportation Corp.*, 71 F. (2d) 104 (C. C. A. 1).

[6] Cf. *Commissioner* v. *Auto Strop Safety Razor Co.*, 74 F. (2d) 226 (C. C. A. 2); *Carroll-McCreary Co.* v. *Commissioner*, 124 F. (2d) 303 (C. C. A. 2). (In these cases the applicable Treasury regulations expressly provided that such a cancellation results in a contribution to capital.) But cf. *Helvering* v. *Jane Holding Corp.*, 109 F. (2d) 933 (C. C. A. 8).

[7] Cf. *Hirsch* v. *Commissioner*, 115 F. (2d) 656 (C. C. A. 7); but cf. *Sportwear Hosiery Mills* v. *Commissioner*, 129 F. (2d) 376, 383 (C. C. A. 3).

by the cancellation of his debts obtained the free use of assets which presumably would have gone to pay those debts, realized income which was properly taxed.

That the taxpayer had in prior years' returns deducted the amounts here cancelled also points to the conclusion that the gains now realized were properly taxable. The lower federal courts have consistently recognized that the reacquisition or release of amounts previously deducted from income are taxable as restorations to income in the year of reacquisition. *Helvering* v. *Jane Holding Corp., supra.; Helvering* v. *State-Planters Bank & Trust Co.*, 130 F. (2d) 44 (C. C. A. 4).* And this Court, while never squarely ruling on

---

* Among the many instances of taxation as restored income of previously deducted, but ultimately reacquired, items are: Items deducted as expenses for which there was subsequent reimbursement (*Buffalo Union Furnace Co.* v. *Helvering*, 72 F. (2d) 399, 403 (C. C. A. 2)); settlement with employees for less than amounts previously deducted as expense (*Commissioner* v. *Vandeveer*, 114 F. (2d) 719, 722–723 (C. C. A. 6)); debts deducted as bad in prior years and subsequently paid (*Commissioner* v. *Liberty Bank & Trust Co.*, 59 F. (2d) 320 (C. C. A. 6)); *Askin & Marine Co.* v. *Commissioner*, 66 F. (2d) 776 (C. C. A. 2)); wages deducted as expense but uncollected are income when subsequently charged back to profit and loss (*Chicago, R. I. & P. Ry. Co.* v. *Commissioner*, 47 F. (2d) 990 (C. C. A. 7), certiorari denied, 284 U. S. 618; *Charleston & W. C. Ry. Co.* v. *Burnet*, 50 F. (2d) 342 (App. D. C.)); unclaimed deposits credited to surplus (*Boston Consol. Gas Co.* v. *Commissioner*, 128 F. (2d) 473 (C. C. A. 1)).

the point, has suggested that items of income previously deducted or accrued as reserve become taxable when released. *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, 352; [see also *S. Rossin & Sons* v. *Commissioner,* 113 F. (2d) 652, 654 (C. C. A. 2)]; cf. *Burnet* v. *Sanford & Brooks Co.,* 282 U. S. 359. Just as in the latter case, the reimbursement of earlier expenses was held to constitute income, so here, the release from the obligation to pay items previously deducted as accrued must be surcharged to income in order that the taxpayer's returns accurately reflect the facts of its financial affairs. Cf. *Buffalo Union Furnace Co.* v. *Helvering,* 72 F. (2d) 399, 403 (C. C. A. 2).*

Accordingly, under both the doctrine of the *Kirby* case and the theory of the *Maryland Casualty* case, the forgiven indebtedness, if not made as a gift (within the meaning of Section 22 (b) (3) of the Revenue Act of 1936), was properly taxable as income to the debtor. The circuit

---

* In this connection it should be noted that while the taxpayer's income for 1937 was treated as being increased only to the extent that the amount of deductions taken for accrued rent and interest offset income in prior years' tax returns (R. 6, 40) the rationale of these cases properly authorizes inclusion of the entire amount previously deducted. Cf. *Helvering* v. *State-Planters Bank & Trust Co., supra.* Compare Section 116 of the Revenue Act of 1942 (adding subparagraph (12) to Section 22 of The Internal Revenue Code), providing for the first time that the recovery of a previously deducted item (here, bad debts) shall be taxed only to the extent that a tax benefit was received in previous years.

court of appeals did not question this conclusion since its decision turned upon whether the transactions resulted in a gift.

B. *The cancellation of indebtedness was not made as a gift within the meaning of Section 22 (b) (3) of the Revenue Act of 1936*

In holding that the creditor's cancellations in this case were "gifts," the court below relied solely on the fact that no "consideration" (*i. e.*, nothing of commercial value) was received by the creditors for forgiving the debts.[10] But the refinements of the law of contracts do not mark out the boundaries of tax conceptions. A broader inquiry than simply whether the giver received "consideration" which would bind him contractually must be made in determining whether given disbursals result in gifts rather than taxable income under Section 22 of the Revenue Act of 1936. The intention of the person making the payment

[10] In its opinion the court erroneously relied upon Article 64 of Treasury Regulations 77, promulgated under the Revenue Act of 1932. The applicable regulation is found, however, in Article 22 (a)-14 of Treasury Regulations 94, promulgated under the Revenue Act of 1936 (Appendix, *infra*, p. 21).

In that connection it should be noted that the court also erroneously stated in its opinion that (R. 49): "The Government freely conceded that unless the forgiveness of indebtedness in each of these instances was based upon a consideration, it would amount to a gift, and gifts are not taxable as income to the donee." No such concession was made on brief or otherwise. However, the court denied a motion to delete the statement from the opinion. (R. 51-52.)

is the ultimate factor to be ascertained, since an intention to make a gift is at least necessary, if not itself wholly sufficient, to differentiate a gift from taxable income under Section 22. *Bogardus* v. *Commissioner*, 302 U. S. 34; see also, *Helvering* v. *National Grocery Company*, 304 U. S. 282, 289, n. 5. In that light, "consideration," although relevant, is not controlling (*Sportwear Hosiery Mills* v. *Commissioner*, 129 F. (2d) 376, 382 (C. C. A. 3)), and the voluntary character of the payment does not of itself, therefore, constitute the forgiveness a gift. Cf. *Old Colony Trust Company* v. *Commissioner*, 279 U. S. 716.[11] And on the other hand a payment made in the context of commercial dealing, and in anticipation of business benefit, although perhaps not sufficient to constitute "consideration" in the contractual sense lacks the donative intention which a gift requires. *Haden Co.* v. *Commissioner*, 118 F. (2d) 285 (C. C. A. 5), certiorari denied, 314 U. S. 622, *Sportwear Hosiery Mills* v. *Commissioner, supra.*

Since the court below predicated its decision exclusively on a finding of no "consideration" it did not find it necessary to ascertain what, in fact, were

[11] See also, *Sportwear Hosiery Mills* v. *Commissioner, supra; Fitch* v. *Helvering*, 70 F. (2d) 583, 585 (C. C. A. 8); *Noel* v. *Parrott*, 15 F. (2d) 669, 671 (C. C. A. 4); *Weagant* v. *Bowers*, 57 F. (2d) 679 (C. C. A. 2); *Fisher* v. *Commissioner*, 59 F. (2d) 192 (C. C. A. 2); *Bass* v. *Hawley*, 62 F. (2d) 721 (C. C. A. 5).

the creditors' intentions in forgiving the debts here. This question, *i. e.*, whether the payments were intended as a gift (as distinguished from whether or not they resulted in a gift) is a question of fact. Cf. *Bogardus* v. *Commissioner, supra.* The record in this case discloses that the reduction of rent arrearages was first suggested by the taxpayer, who had been a tenant of the lessor for a number of years, in the course of negotiating for a new lease at a reduced rental, and that at that time the lessor intimated that an adjustment could be reached (R. 13, 16). Subsequent discussions of the problem pivoted on the question of how much of the arrearages the debtor would pay (R. 13–14). Similarly, the cancellation of interest accruing after January 1, 1932, was procured in the ordinary course of business; the president of the taxpayer suggested to its creditors that the taxpayer was unable to charge interest on its outstanding accounts, that the creditors were forgiving interest requirements for others in the industry, and that his firm wished a similar adjustment (R. 14–16). The interest charges after January 1, 1932, were cancelled, and those arising before that date were to be paid (R. 14). On this record the Board of Tax Appeals found as a fact that the cancellations were effected for business reasons and that there was no intention to make a gift (R. 42). This inference of fact, thus supported by substantial evi-

dence, is conclusive. *Wilmington Trust Co.* v. *Helvering*, 316 U. S. 164, 168.[12]

The cancellations of indebtedness in this case, negotiated as normal arms-length business transactions, and made in anticipation of commercial benefit (cf. *Haden Co.* v. *Commissioner*, 118 F. (2d) 285 (C. C. A. 5), *Sportwear Hosiery Mills* v. *Commissioner*, 127 F. (2d) 376, 382) were certainly no more acts of "spontaneous generosity" (cf. *Bogardus* v. *Commissioner, supra*) than was the award of extra compensation in *Old Colony Trust Company* v. *Commissioner, supra*. Like that award, they were properly taxable as income to the recipient. The court below therefore erred in concluding that they were gifts exempted from taxation by Section 22 (b) (3).

II

THE INCOME RESULTING FROM THE CANCELLATION OF INDEBTEDNESS WAS PROPERTY TAXABLE AS INCOME FOR THE YEAR 1937

Since the gains here realized were taxable income, there remains to be considered only whether

---

[12] Since the presumption of correctness which attaches to the Commissioner's determination places the burden of proof on the taxpayer [*Burnet* v. *Houston*, 283 U. S. 223, 227-228; *Welch* v. *Helvering*, 290 U. S. 111, 115; *Helvering* v. *Taylor*, 293 U. S. 507, 514], the propriety of the Board's conclusion is in this case emphasized by the taxpayer's failure to introduce any evidence to show a donative intent (R. 42).

they were properly taxed as income for the year 1937, a question which the court below did not decide. The Board of Tax Appeals found as a fact that the debts were forgiven in 1937 (R. 40). The record discloses that, although the taxpayer's testimony supports the contention that the creditors agreed to cancel the rent and interest arrearages in 1934 and 1936 respectively, all the other evidence substantiates the Board's finding that the cancellations actually occurred in 1937. And the taxpayer's testimony in this matter was inconsistent with its own conduct.[13] Since "it is the function of the Board, not the Circuit Court of Appeals, to weigh the evidence, to draw inferences from the facts, and to choose between conflicting inferences", and since "the court may not substitute its view of the facts for that of the Board", the conclusion that the cancellations occurred in 1937, supported as it is by substantial evidence, cannot now be upset. *Wilmington Trust Co.* v. *Helvering*, 316 U. S. 164, 168; *Helvering* v. *Lazarus & Co.*, 308 U. S. 252; *Helvering* v. *Kehoe*, 309 U. S. 277.

The taxpayer contended below that the gain thus realized should not be included in its 1937

---

[13] For example, although the taxpayer's president testified to the effect that he understood the interest arrearages to have been cancelled in 1936, the taxpayer's returns for that year disclose that items reflecting the very interest charges claimed to have been cancelled were deducted (R. 41).

return because it has offered to pay additional taxes for 1934 and 1936, measured upon the assumption that the rent and interest were cancelled in those years respectively, and that under Section 3801 of the Internal Revenue Code,[14] the Commissioner is authorized to make such adjustments respecting 1934 and 1936. The whole question, however, is whether the income was realized in 1934 and 1936 or in 1937. To invoke Section 3801, it would be necessary to assume that the items here in question represented income in 1934 and 1936 and were improperly omitted from the taxpayer's returns in those years.[15] The Board of Tax Appeals, however, found as a fact that the cancellations were income in 1937, not in 1934 or 1936. Hence, the remedy afforded by Section 3801 cannot possibly be available here.[16] Indeed, the argument based on that section is wholly irrelevant, because if the income was in fact realized in 1934 and 1936 (a necessary condition for invoking the section) it would not be taxable in 1937 and the suggested adjustments would not be required.

---

[14] See Appendix, *infra*, pp. 19–21.

[15] It is not disputed that the deductions for rent and interest were properly taken for the years in which accrued.

[16] It is therefore unnecessary to do more than point out that for other reasons also, the taxpayer's contention misconceives the scope of Section 3801. Even if the items here involved were properly taxable in 1934 and 1936, the remedy afforded by that section does not extend to adjustments of the kind here urged. See Maguire, Surrey, and Traynor, *Section 820 of the Revenue Act of 1938*, 48 Yale L. J. 719.

CONCLUSION

The cancellations of indebtedness for rent and interest were properly taxed as income to the taxpayer for 1937, and the court below erred in failing to sustain the determination of the Board of Tax Appeals. The judgment of the court below should be reversed.

Respectfully submitted,

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
HELEN R. CARLOSS,
SAMUEL H. LEVY,
NEWTON K. FOX,
Special Assistants to the Attorney General.

NOVEMBER, 1942.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * *

(3) *Gifts, Bequests, and Devises.*—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income); * * *

* * * * *

Internal Revenue Code:

SEC. 3801. MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES.

(a) *Definitions.*—For the purpose of this section—

(1) *Determination.*—The term "determination under the income tax laws" means—

(A) A closing agreement made under section 3760;

(B) A decision by the Board of Tax Appeals or a judgment, decree, or other order by any court of competent jurisdiction, which has become final; or

(C) A final disposition by the Commissioner of a claim for refund. For the purposes of this section a claim for refund shall be deemed finally disposed of by the Commissioner—

(i) as to items with respect to which the claim was allowed, upon the date of allowance of refund or credit or upon the date of mailing notice of disallowance (by reason of offsetting items) of the claim for refund, and

(ii) as to items with respect to which the claim was disallowed, in whole or in part, or as to items applied by the Commissioner in reduction of the refund or credit, upon expiration of the time for instituting suit with respect thereto (unless suit is instituted prior to the expiration of such time).

Such term shall not include any such agreement made, or decision, judgment, decree, or order which became final, or claim for refund finally disposed of, prior to August 27, 1938.

* * * * *

(b) *Circumstances of Adjustment.*—When a determination under the income tax laws—

(1) Requires the inclusion in gross income of an item which was erroneously included in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer; or

(2) Allows a deduction or credit which was erroneously allowed to the taxpayer for another taxable year or to a related taxpayer; or

(3) Requires the exclusion from gross income of an item with respect to which tax was paid and which was erroneously excluded or omitted from the gross income of the taxpayer for another taxable year or from the gross income of a related taxpayer; or

(U. S. C., Title 26, Sec. 3801)

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 22 (a)–14. *Cancellation of indebtedness.*—The cancellation of indebtedness, in whole or in part, may result in the realization of income. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, income in the amount of the debt is realized by the debtor as compensation for his services. A taxpayer realizes income by the payment or purchase of his obligations at less than their face value. (See article 22 (a)–18.) If a shareholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation. * * *

U. S. GOVERNMENT PRINTING OFFICE 1942